

Federal Fiscal Programs

THE budget submitted to Congress last month proposes a fiscal plan designed to moderate inflationary pressures, to limit the relative size of the Federal Government in the economy, and to move the economy toward full employment.

The budget estimates provide for significant reductions in Federal spending as compared with levels envisaged earlier for fiscal 1973. The impact of these reductions and continued restraint is estimated to limit unified budget outlays to the level of full-employment revenues in fiscal 1974. The budget calls for no new major spending initia-

tives, but existing law provides for increases in spending, especially for social security. Although no new income tax increases are proposed, already enacted increases in social security taxes are an important element of growth in fiscal 1974 receipts.

Unified budget outlays and receipts

The unified budget projects an increase in outlays of \$18.9 billion in fiscal 1974, somewhat more than the \$17.9 billion advance estimated for the current year (table 1). Civilian programs account for about three-

fourths—\$14.2 billion—of the 1974 increase. National defense outlays, mainly by the Department of Defense, are to rise \$4.6 billion. In terms of budget authority, civilian programs advance only \$2.1 billion in fiscal 1974, and national defense programs increase \$5.6 billion. Budget authority, usually in the form of appropriations, are the amounts authorized by Congress that permit Federal agencies to enter into obligations requiring either immediate or future outlays of money. Congress will have to act on \$172.8 billion of the total budget authority proposed for fiscal 1974; the remaining \$115.2 billion, mainly for trust fund programs, will be available under existing laws without additional action by Congress.

Among civilian functions, substantial outlay gains in fiscal 1974 are projected for income security (\$6.1 billion), health (\$3.7 billion), natural resources and the environment (\$2.8 billion), and interest (\$1.9 billion). Decreases are slated for commerce and transportation (\$1.0 billion), general revenue sharing (\$0.8 billion), agriculture and rural development (\$0.5 billion), and education and manpower (\$0.4 billion). Outlays for other civilian functions are to increase \$2.3 billion.

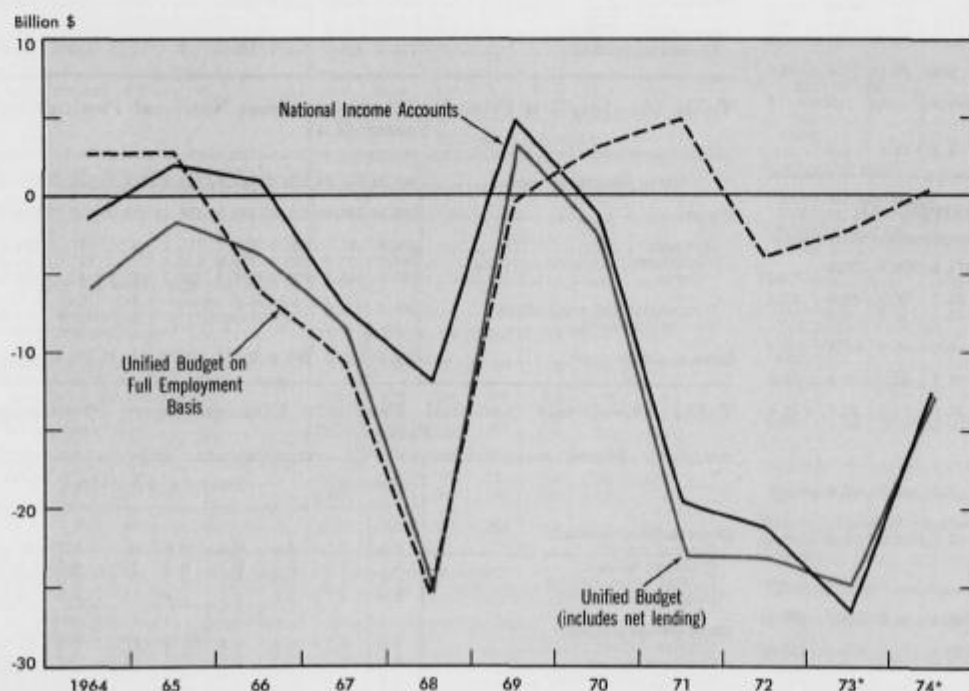
Receipts are estimated to rise \$31 billion, reflecting growth in individual and corporate incomes generated by the continued economic expansion assumed in the budget projections. Increases in both the taxable earnings base and the payroll tax rate for social security contribute to the rise in receipts.

Unified budget receipts are to increase \$23.8 billion in fiscal 1974; estimates are based on an increase in GNP from \$1,152 billion in calendar 1972 to \$1,267 billion in calendar 1973,

CHART 7

Federal Fiscal Position

Unified budget deficit declines in fiscal year 1974



*Estimates from "The Budget of the United States Government, 1974."

Table 1.—Federal Government Receipts and Expenditures, Fiscal Years 1972-74

[Billions of dollars]			
	1972 actual	Estimates	
		1973	1974
Unified budget			
Receipts.....	268.6	225.0	258.0
Outlays.....	293.0	240.8	288.7
Surplus or deficit (-).....	-24.2	-14.8	-12.7
Full-employment surplus or deficit (-).....	-2.0	-2.8	.8
National income accounts			
Receipts.....	211.8	223.2	263.0
Expenditures.....	223.1	250.0	278.8
Surplus or deficit (-).....	-21.1	-26.6	-12.8

Sources: "The Budget of the United States Government, 1974" and BEA.

existed in the fall of 1972. The current estimate incorporates reductions in outlays resulting from program reductions and terminations, deferrals of various payments, and additional sales of financial assets, offshore oil leases, and stockpiled materials.

NIA deficit declines

Under the concepts used in the Federal sector of the national income accounts (NIA) (table 3), the decline in the deficit in fiscal 1974 is somewhat greater than in the unified budget—\$14.1 billion vs. \$12.1 billion. Expenditures on the NIA basis increase \$15.6 billion—\$3.3 billion less than unified budget outlays—and NIA receipts increase \$29.7 billion—\$1.3 billion less than unified budget receipts.

The smaller increase in NIA expenditures than in unified budget outlays is the result of the following factors: (1) deliveries in the NIA exceed cash outlays \$2.8 billion in 1973, but only \$0.3 billion in 1974; (2) proceeds from the current sales of offshore oil leases, which are netted against outlays in the unified budget but excluded from the NIA, decline from \$2.8 billion in 1973 to \$1.8 billion in 1974; (3) budget outlays, but not NIA expenditures, are reduced in 1973 by the transfer of more than \$1

billion from a deposit fund excluded from the budget; there is no similar transfer for fiscal 1974; and (4) financial transactions, which are excluded from the NIA, account for only \$0.9 billion of unified budget outlays in fiscal 1973, but for about \$1.5 billion in 1974, when asset sales decline. The most important factor working in the opposite direction is sharply increased spending by the Postal Service, largely for capital equipment. Beginning with fiscal 1974, the unified budget totals show only the Federal payment to the Postal Service; in contrast, the NIA continues to record capital spending by the Postal Service as part of nondefense purchases, and the postal operating deficit as part of subsidies less current surplus of government enterprises.

Calendar 1973 deficit, NIA basis

On the basis of the budget document, the Bureau of Economic Analysis (BEA) estimates that the NIA deficit in calendar 1973 will be about \$17 billion, compared with a preliminary figure of \$18½ billion for calendar 1972. Expenditures will rise more than \$21 billion and receipts almost \$22½ billion. The net effect of tax changes in calendar 1972 and 1973 (including the effect of overwithholding and the associated re-

a rise of 10 percent, compared to 9.7 percent in calendar 1972. Personal income is projected at \$1,018 billion, up \$82 billion, or 8.8 percent. Corporate profits before taxes are to advance \$14 billion, or 15 percent, to \$108 billion.

The deficit in the unified budget is to decline \$12.1 billion—from \$24.8 billion in 1973 to \$12.7 billion in 1974 (chart 7). The deficit now estimated for fiscal 1973 is considerably less than the estimate of \$30 billion to \$35 billion that was in wide circulation early last fall. Table 2 shows the difference between "unconstrained" budget outlays and the current estimate for fiscal 1973. Unconstrained outlays represent the outlays resulting from existing programs as they

Table 2.—Fiscal 1973 Unified Budget Outlays: Difference Between "Unconstrained" Total and Current Estimate

(Billions of dollars)	
"Unconstrained" estimate.....	261.0
Limitation on open-end social service grant program.....	-2.8
Deferral of various payments, primarily shifting the June 1973 general revenue sharing payment to July 1973.....	-2.0
Additional sales of financial assets.....	-1.1
Additional sales of offshore oil leases.....	-1.0
Farm price supports.....	-1.7
Additional stockpile disposals.....	-1.4
Medicare and Medicaid.....	-1.4
Absorption of January 1973 pay raises.....	-1.3
Water pollution.....	-1.8
All other (mainly program reductions and terminations).....	-2.7
January 1973 budget estimate.....	248.8

Source: "The Budget of the United States Government, 1974."

Table 3.—Federal Government Receipts and Expenditures, NIA Basis

(Billions of dollars)							
	Fiscal year			Calendar 1972			
	1972 actual	1973	1974	I	II	III	IV
		Estimates		Seasonally adjusted at annual rates			
Federal Government receipts.....	211.9	233.3	263.0	221.4	224.9	229.8	.....
Personal tax and nontax receipts.....	100.1	104.2	116.6	105.6	107.3	109.1	113.6
Corporate profits tax accruals.....	33.6	38.7	41.0	34.0	35.2	36.7	.....
Indirect business tax and nontax accruals.....	20.1	20.5	21.6	19.9	19.7	20.2	20.6
Contributions for social insurance.....	58.3	69.8	88.2	61.7	62.6	63.8	65.3
Federal Government expenditures.....	233.1	258.9	276.5	218.3	216.5	241.6	262.7
Purchases of goods and services.....	103.1	106.8	111.5	105.7	108.1	108.4	104.0
National defense.....	74.3	74.6	75.9	76.7	78.6	78.1	75.2
Other.....	28.8	31.1	35.6	29.0	29.4	30.2	28.8
Transfer payments.....	78.5	91.5	101.9	70.4	80.4	82.0	91.8
To persons.....	75.8	88.9	99.1	70.6	77.6	79.4	88.8
To foreigners (net).....	2.8	2.7	2.8	2.8	2.8	2.6	2.2
Grants-in-aid to State and local governments.....	39.7	41.6	41.6	32.4	39.1	34.4	45.5
Net interest paid.....	13.5	14.6	15.8	13.1	13.8	13.6	13.7
Subsidies less current surplus of government enterprises.....	5.2	6.3	4.8	5.6	6.0	6.9	5.7
Less: Wage accruals less disbursements.....	0	0	0	0	-1	0	0
Surplus or deficit (-), national income and product accounts.....	-21.1	-25.6	-12.5	-14.8	-21.5	-11.8	.....

Sources: "The Budget of the United States Government, 1974" and BEA.

funds in 1973) is to lower calendar 1973 receipts about \$2½ billion; gross revenue growth in calendar 1973 excluding the effect of tax changes is approximately \$25 billion.

Impact of overwithholding

Overwithholding has characterized the personal income tax system in the United States for many years, but the total of overwithheld payments has been relatively small. Within the aggregate, however, withholdings frequently fell short of liabilities for many taxpayers, particularly for families with more than one source of wage and salary income; this was particularly true in 1971, following changes in withholding tax rates in January of that year. The withholding schedules for 1972, established in the Revenue Act of 1971, were designed to correct the 1971 experience and to allow taxpayers to match more closely their withheld payments with their liabilities. For this reason, the 1972 schedules were set high, but in calculating withholdings, taxpayers were allowed to claim additional exemptions to the extent necessary to align their withheld taxes with their liabilities. For the most part, however, taxpayers did not adjust their withholdings downward. As a result there were exceptionally large overwithholdings in calendar 1972 and the prospect is for exceptionally large refunds in calendar

1973 (or exceptionally low final settlements for taxpayers who ended up owing taxes on 1972 incomes).

According to estimates prepared by the Treasury Department's Office of Tax Analysis, overwithholding in 1972 associated with the 1972 changes in the withholding tax tables amounted to roughly \$10 billion (table 4). This was partly offset by an associated reduction of approximately \$1 billion in quarterly declaration payments. Thus, the net amount of overpayments in 1972 associated with the 1972 changes in the schedules was roughly \$9 billion. The \$9 billion overpayment is projected to increase 1973 refunds or lower 1973 final settlements from the levels they otherwise would have reached. The estimates assume that overwithholding will moderate in 1973, declining gradually to an annual rate of \$6 billion by midyear, with quarterly declarations remaining roughly \$1 billion below what they otherwise would have been. This results in a permanent overwithholding (net of declarations) of approximately \$5 billion. In the calculation of seasonally adjusted quarterly estimates in the NIA, the corresponding \$5 billion reduction in net settlements (final settlements less refunds) is spread evenly over the four quarters of the calendar year; the remaining reduction in net settlements—\$4 billion in 1973 and much less in 1974—is considered temporary, and will be recorded at the time that net settlements occur in the first half of the year.

Budget path on the NIA basis

If budget projections are realized, the NIA deficit will grow from about \$18½ billion in the second half of 1972 to \$26 billion in the first half of calendar 1973 (quarterly and half year figures in this article are expressed at seasonally adjusted annual rates), and then drop to \$8½ billion in the second half. Expenditures will increase \$15 billion from the second half of 1972 to the first half of 1973 (chart 8). Transfer payments will rise almost \$9½ billion, largely due to recently enacted social security benefit increases. Grants-in-aid also increase sharply—about \$2½ billion—mainly due to general revenue

sharing. Purchases are boosted \$2½ billion by the Federal pay raise effective in January 1973. Interest payments also increase but subsidies fall, largely because of lower farm price support payments.

Receipts increase about \$7½ billion in the first half of calendar 1973. Increases in the social security payroll tax rate and in the maximum earnings subject to the tax account for \$10½ billion of the large gain in social insurance contributions. Corporate tax liabilities advance markedly; indirect business taxes also increase, despite a small reduction in the telephone excise tax. Partly offsetting these increases is a large decline in personal tax payments, largely attributable to refunds resulting from the overwithholding in calendar 1972. The growth in withheld taxes also slows during this period for, as already indicated, it is assumed that some individuals will adjust their withholdings downward.

Expenditures increase only \$2 billion in the second half of calendar 1973. Defense purchases are essentially flat; nondefense purchases continue to increase. Transfer payments rise only

Table 4.—Impact of Overwithholding on Personal Tax Payments, NIA Basis

[Billions of dollars, seasonally adjusted at annual rates]

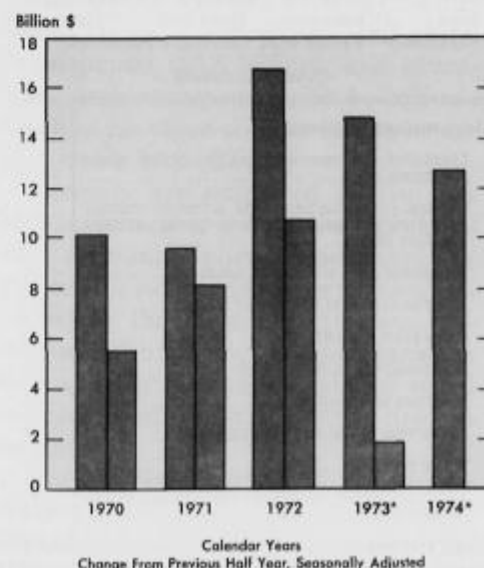
	Total	Withheld	Other ¹
1972:			
First half.....	9.1	10.0	-0.9
Second half.....	9.1	10.0	-0.9
1973:			
First half.....	-6.3	7.0	-13.3
Second half.....	0	6.0	-6.0
1974:			
First half.....	-1.0	6.0	-7.0
Second half.....	0	6.0	-6.0
1975:			
First half.....	0	6.0	-6.0
Second half.....	0	6.0	-6.0

1. Includes quarterly declarations and final settlements net of refunds.

NOTE.—Seasonally adjusted half-years will average to calendar year totals but will not average fiscal year totals; see text.

Sources: Estimates by BEA and Treasury Department, Office of Tax Analysis.

CHART 8
Federal Expenditures (NIA Basis)
Large increases expected in first half of 1973 and first half of 1974



\$2 billion, of which roughly three-quarters is due to new medicare benefits for the disabled. Grants-in-aid and subsidies decline; interest is unchanged. Receipts, by contrast, increase \$19½ billion, resulting in a sharp reduction in the deficit. An important element in the receipts projection is a rebound in personal taxes as refunds fall to more normal levels and rapid gains in wages boost withholdings. Also, it is assumed that individual adjustments in withholding payments are largely completed by midyear. Social insurance contributions continue to advance, aided by increases in supplemental medical insurance fees and railroad retirement contributions.

Expenditures grow much more rapidly in the first half of 1974. Another pay raise for military and civilian employees, effective January 1, 1974, adds \$2½ billion to purchases. Transfers are raised, and grants-in-aid lowered, by the Federal takeover of State adult welfare programs for the aged, blind, and disabled. However, other grants-in-aid increase somewhat, resulting in moderate overall growth in this spending category. Receipts also continue to rise, with all the NIA receipt categories showing projected increases; another increase in the social security tax base adds over \$2 billion beginning January 1, 1974.

Difference between seasonally adjusted and unadjusted data

Generally, the difference between seasonally adjusted and unadjusted fiscal year totals is relatively small (although no attempt is made to force them to equality). In the Federal sector, as in the rest of the NIA, seasonally adjusted and unadjusted data are exactly equal only on a calendar year basis.

However, for fiscal 1973, the four quarters of NIA receipts at seasonally adjusted annual rates will average to a figure nearly \$4½ billion larger than the unadjusted total; in fiscal 1974, they will average to a figure at least \$1 billion larger than the unadjusted total. These large differences are mainly due to two factors. First, the January 1973 increase in the social security tax

base will increase seasonally adjusted contributions in fiscal 1973 \$1.8 billion, but increase unadjusted contributions only \$0.2 billion; the January 1974 base increase will increase seasonally adjusted contributions in fiscal 1974 \$1.1 billion, but increase unadjusted contributions \$0.2 billion. Second, it is assumed that some of the refunds associated with overwithholding will recur regularly in years subsequent to 1973, and this recurring amount is seasonally adjusted by smoothing it over all four quarters of calendar 1973, rather than concentrating it entirely in the first half; this will result in seasonally adjusted personal taxes in fiscal 1973 exceeding the unadjusted totals \$2.7 billion.

Full-employment surplus

As measured by changes in the full-employment surplus, fiscal policy was clearly expansionary in calendar 1972 and will become more restrictive in calendar 1973. However, estimates of the magnitude of the stimulus in 1972,

and of its reduction in 1973, depend on the treatment of overwithholding and of the associated refunds in the calculation of full-employment revenues.

The *Annual Report of the Council of Economic Advisers* suggests that the proper treatment of overwithholding for purposes of fiscal analysis depends on the view taken of its effects on consumer spending. If consumption depends largely on "permanent" incomes, temporary tax changes, such as overwithholding and the subsequent large refunds, will not alter spending significantly. On the other hand, if consumer spending is motivated by currently available disposable income, whether temporary or permanent, consumption will be affected by overwithholding. The size of the temporary changes in disposable income may also be a factor; for example, consumers may not have reduced consumption as a result of relatively small increases in weekly withholdings in 1972, but they may react differently to the much larger lump-sum refunds in 1973. The Council believes that it is appropriate to

The Full-Employment Surplus

The full-employment surplus (FES) is an estimate of the amount by which Federal revenues would exceed Federal expenditures if the economy were operating at a hypothetical full-employment level of activity at current price levels.

Although the FES concept dates back to work done by the Committee for Economic Development in the 1940's, it was first given major prominence by the Council of Economic Advisers in the early 1960's. At that time a practical need was felt for a measure of the impact of budget policy on the economy better than the actual budget surplus or deficit. The 1974 budget recently submitted to Congress relies heavily on the FES concept.

Use of the actual budget to judge the impact of fiscal policy can be misleading because its surplus or deficit reflects the economy's influence on the budget as well as the influence of the budget on the economy. For example, the Government might be taking restrictive fiscal actions but a weakening of the economy could cause the actual deficit to rise, falsely suggesting expansionary policies. On the other hand, a booming economy could lead to a rise in the surplus at a time when tax rates are reduced and expenditure policies become more expansionary. It is in order to abstract from the effect that changing levels of economic activity have on the

budget that a single level, that of a "fully-employed" economy, is used to calculate the FES.

The methodology generally employed in calculations of the full-employment surplus can be summarized in four steps:

(1) Real GNP is estimated on the basis of potential full-employment growth, and converted to current dollars using the actual rate of price change.

(2) Full-employment income is divided into various tax bases, such as personal income and corporate profits.

(3) Effective tax rates under present laws are computed for each tax base, and full-employment revenues derived.

(4) Full-employment expenditures are calculated by subtracting from actual expenditures the difference between actual and estimated full-employment levels of unemployment compensation.

Although the FES is generally calculated on an NIA basis, it can also be calculated in terms of unified budget data, as is done in the 1974 Budget document.

The absolute level of the full-employment surplus is of limited significance for indicating the extent of fiscal restraint or stimulus. Changes in the FES from period to period are generally considered to be the more significant indicators.

Table 5.—Changes in Full-employment Surplus, NIA Basis

[Billions of dollars, seasonally adjusted at annual rates]

Calendar year	Change from previous half-year	
	Including overwithholding and associated refunds	Excluding overwithholding and associated refunds
1972:		
First half.....	-0.8	-9.9
Second half.....	-4.3	-4.3
1973:		
First half.....	-11.4	4.0
Second half.....	12.8	6.5
1974:		
First half.....	-2.3	-1.3

Sources: Council of Economic Advisers and BEA.

adjust the full-employment surplus to exclude the impact of overwithholding and the associated refunds if the permanent income hypothesis is adopted; on the other hand, the impact of overwithholdings should be included in the full-employment surplus if it is felt that temporary tax changes significantly affect consumption. Table 5 shows half-year changes in the full-employment surplus (NIA basis) under both assumptions. (Overwithholding is excluded from the official estimates, published in the Budget document, of the unified budget on a full-employment basis—table 1.)

The treatment of overwithholding has a considerable impact on the behavior of the Federal full-employment surplus (NIA basis). If overwithholding and the associated refunds are treated like a tax law change and thus included in full-employment revenues, the swing toward fiscal stimulus in calendar 1972 and the swing toward fiscal restraint in calendar 1973 are much less than if overwithholding is excluded from the full employment calculation.

The impact of the swing in the Federal full-employment budget position is also dependent on how States and localities use the general revenue sharing funds being paid to them by the Federal Government. To the extent that these governments spend the funds, reduce existing taxes, or defer tax increases already planned, revenue sharing will have an expansionary impact on the economy in line with

its impact on the Federal full-employment surplus. However, to the extent that State and local governments temporarily use the revenue sharing funds to retire debt, or to

invest in financial assets, they will offset the fiscal stimulus (or increase the fiscal restraint) implied by the Federal full-employment budget position.

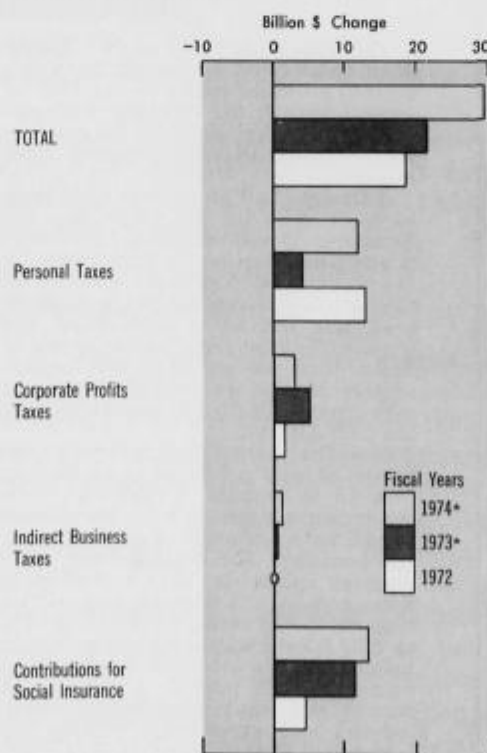
Fiscal 1974 Receipts

FEDERAL receipts in fiscal 1974 are projected to total \$263 billion on the NIA basis, an advance of \$29.7 billion from the estimate for fiscal 1973. This compares with increases of \$21.4 billion in fiscal 1973 and \$18.9 billion in 1972.

NIA receipts, which are recorded mainly on an accrual basis, increase somewhat less rapidly in 1974 than cash collections; in 1973 the increase in NIA receipts exceeds the increase in cash collections. Accruals were \$1.2

billion smaller than collections in 1972, but exceed collections \$3.6 billion in 1973 and \$1.7 billion in 1974. The widening of the gap in 1973 and the narrowing in 1974 result principally from the rapid economic expansion in fiscal 1973—which builds up tax accruals faster than collections—followed by a more moderate rate of expansion in 1974.

The 1974 increase in NIA receipts is 12.7 percent, the largest percentage gain since fiscal 1969 when the income tax surcharge was imposed. One-fourth of the increase is accounted for by tax changes: the net effect of tax changes is to increase receipts \$7.5 billion while income growth accounts for a gain of \$22.2 billion (table 6). For 1973, a \$26.6 billion increase resulting from higher incomes is partly offset by a \$5.2 billion decline due to tax changes, mainly the impact of overwithholding.

Changes in Federal Government Receipts (NIA Basis)

* Estimate by BEA.

U.S. Department of Commerce, Bureau of Economic Analysis

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Table 6.—Breakdown of Changes in Federal Receipts, NIA Basis

[Billions of dollars]

	Change from previous fiscal year		
	1972	1973	1974
Total receipts, NIA basis.....	18.9	21.4	29.7
Amount due to higher incomes.....	22.2	26.6	22.2
Amount due to tax changes.....	-3.3	-5.2	7.5
Personal tax and nontax payments.....	13.0	4.1	12.4
Amount due to higher incomes.....	13.4	14.5	12.9
Amount due to tax changes.....	-0.4	-10.4	-0.5
Corporate profits tax accruals.....	1.5	5.2	2.9
Amount due to higher incomes.....	5.1	6.4	3.5
Amount due to tax changes.....	-3.6	-1.2	-0.6
Indirect business tax and nontax accruals.....	0	.4	1.1
Amount due to higher incomes.....	1.7	1.0	1.3
Amount due to tax changes.....	-1.7	-0.6	-0.2
Contributions for social insurance.....	4.5	11.5	13.4
Amount due to higher incomes.....	2.1	4.5	4.6
Amount due to tax changes.....	2.4	7.0	8.8

Source: Estimates by BEA.

Table 7.—Personal Tax and Nontax Payments, NIA Basis

[Billions of dollars]

	Fiscal year			Change from previous fiscal year		
	1972	1973	1974	1972	1973	1974
		Estimates			Estimates	
Total personal tax and nontax payments	100.1	104.2	116.6	13.0	4.1	12.4
Withheld.....	83.5	96.8	108.9	9.4	13.3	12.1
Resulting from:						
Overwithholding.....	5.0	8.5	6.0	5.0	3.5	-2.5
Other.....	78.5	88.3	102.9	4.4	9.8	14.6
Declarations and settlements net of refunds.....	11.0	2.7	2.5	1.8	-8.3	-2.0
Resulting from:						
Overwithholding.....	-6	-9.8	-6.5	-6	-9.2	3.3
Other.....	11.6	12.5	9.0	2.4	.9	-3.5
Estate and gift and nontaxes.....	5.6	4.8	5.2	1.8	-.8	.4
Addendum: Total impact of overwithholding.....	4.4	-1.3	-.5	4.4	-5.7	.8

Sources: BEA and Treasury Department, Office of Tax Analysis.

The 1974 receipts advance resulting from tax changes is principally due to increases in social security tax rates and in the earnings base subject to the social security tax. The net effect of tax changes in excise taxes and personal and corporate income taxes is to lower 1974 NIA receipts.

Personal taxes up \$12.4 billion

Personal tax and nontax payments are estimated at \$116.6 billion, an increase of \$12.4 billion from 1973. This is the net result of an increase of about \$13 billion attributable to higher incomes and a loss of \$0.5 billion because of tax changes. Tax changes associated with the Tax Reform Act of 1969 and the Revenue Act of 1971, including the impact of overwithholding resulting from provisions of the 1971 Act, have little net effect. A loss of \$0.6 billion is accounted for by two items of proposed legislation—an income tax credit for nonpublic elementary and secondary school tuition, and liberalized rules concerning deductions for individual pension plans.

Overwithholding and the associated refunds have a major impact on the distribution of personal tax payments among withholdings, declarations, and net settlements. In addition to adding considerably to the level of withheld payments, overwithholding lowers the combined level of declaration payments and net settlements in all 3 years. As

shown in table 7, the net impact of overwithholding accounted for more than one-third of the 1972 increase in personal taxes, but severely restricts the rate of increase in 1973; its impact on the 1974 advance is relatively small.

Corporate taxes increase

Corporate tax liabilities are projected to increase \$2.9 billion, to a level of \$41.6 billion. An increase of \$3.5 billion resulting from higher profits is partly offset by a decline of \$0.6 billion because of tax changes, mainly the impact of the liberalized depreciation rules enacted in the Revenue Act of 1971.

Indirect business tax and nontax accruals are estimated to increase \$1.1 billion, following an advance of only \$0.4 billion in 1973. Changes in tax rates play a minor role in the 1974 change. The telephone excise tax declines to 8 percent on January 1, 1974, after having been reduced from 10 percent to 9 percent on January 1, 1973. The budget proposes the extension of the interest equalization tax which is due to expire under present law in March 1973. However, the recent devaluation of the dollar is likely to result in a modification of this proposal.

Tax increases boost social insurance contributions

The largest increase in NIA receipts occurs in social insurance contributions,

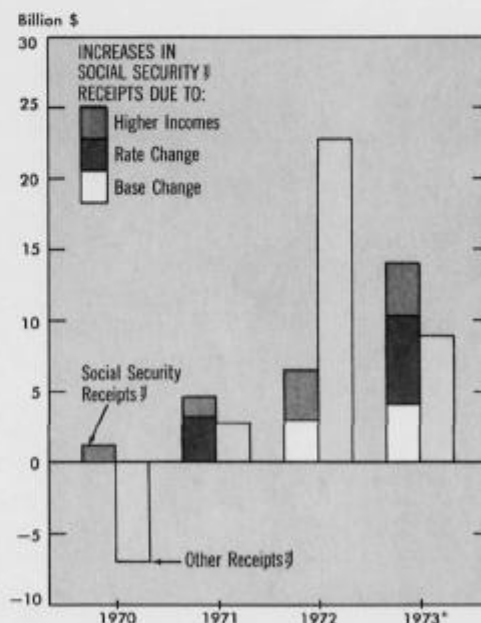
which are projected to advance a record \$13.4 billion to \$83.2 billion. This follows an advance of \$11.5 billion in 1973. Projected economic expansion accounts for about \$4.5 billion of the gains in both years, while tax increases—mainly for social security—account for \$7.0 billion of the 1973 advance and for \$8.8 billion of the 1974 advance.

The combined employer-employee tax rate for social security was raised from 10.4 percent to 11.7 percent on January 1, 1973. The maximum amount of earnings subject to the tax was increased from \$7,800 to \$9,000 on January 1, 1972, and from \$9,000 to \$10,800 on January 1, 1973. An increase to \$12,000 is scheduled under existing law for January 1, 1974.

All three of these increases in the tax base have their most pronounced effect on actual receipts in the second half of the calendar year in which they occur—and thus in the following fiscal year—as

CHART 10

Increases in Social Security Tax Rates and Base are Important in Growth of Federal Receipts



* Estimate

1. Includes old age, survivors, disability, and hospital insurance receipts.

2. Includes personal tax and nontax receipts, corporate profits tax accruals, indirect business tax and nontax accruals, and other contributions for social insurance.

persons reach the earnings maximum later in the year than they do with a lower base. The base increase in January 1973 has its principal impact on fiscal 1974 contributions, and the increase scheduled for January 1974 affects principally fiscal 1975 contributions. However, in the seasonally

adjusted NIA, the base increase is annualized when it occurs. Thus, the January 1973 increase raises contributions about \$3½ billion beginning in the first quarter of calendar 1973, and the January 1974 increase raises contributions about \$2 billion beginning in the first quarter of calendar 1974.

Fiscal 1974 Expenditures

FEDERAL expenditures as measured in NIA are projected to increase \$15.6 billion in fiscal 1974, compared with \$26.8 billion in the current fiscal year (table 3). Personal transfers account for almost two-thirds of the gain (\$10.2 billion) followed by increases in non-defense purchases (\$4.5 billion), defense purchases (\$1.3 billion), and net interest (\$1.2 billion). Subsidies decline \$1.5

billion while grants-in-aid show no change. As shown in table 8, social security benefit and pay increases account for \$9.6 billion, or over 60 percent, of the 1974 advance. General revenue sharing, which contributes \$6.8 billion to the 1973 increase, declines \$0.8 billion in 1974. Of the remaining \$6.8 billion, \$6.4 billion is in nondefense expenditures, a significant decline from 1973 when this category rises \$12 billion.

Pay raises account for rise in defense purchases

National defense purchases reached a peak of \$78 billion in 1969, declined in 1970 and 1971, and turned upward in 1972. They are expected to edge up in the current fiscal year, and to rise somewhat more than \$1 billion in 1974 to nearly \$76 billion.

National defense outlays in the unified budget increase \$4.6 billion in 1974, considerably more than the increase in NIA defense purchases. The large gap is primarily attributable to a sharp decline in the excess of deliveries over payments and a larger than usual increase in retired pay, which is recorded in the NIA as a transfer payment rather than a purchase. Table 9 shows the functional detail of unified budget defense spending, and a reconciliation of those outlays with NIA defense purchases.

Increases in the average compensation of military and civilian personnel have been a major factor in maintaining high levels of national defense purchases for many years (chart 12), and this trend continues in 1973 and 1974. Pay raises going into effect since No-

vember 1971 added \$2.3 billion to defense purchases in 1972, and are expected to add \$4.8 billion in 1973 and \$6.5 billion in 1974; excluding these

Table 8.—Breakdown of Changes in Federal Expenditures, NIA Basis

[Billions of dollars]

	Change from previous fiscal year	
	1973	1974
Total expenditures	26.8	15.6
Social security benefit increases ¹	6.9	7.2
General revenue sharing.....	6.8	-.8
Pay raises.....	2.8	2.4
Other.....	10.3	6.8
Defense ²	-1.7	.4
Nondefense.....	12.0	6.4

1. Includes the 20 percent benefit increase, the effect of social security liberalizations, extended medicare benefits, and supplemental security income.

2. Includes purchases, transfers, grants, and interest.

Source: Estimates by BEA.

Table 9.—Breakdown of National Defense Outlays in the Unified Budget, and Their Relationship to National Defense Purchases on the NIA Basis, Fiscal Years 1972-74

[Billions of dollars]

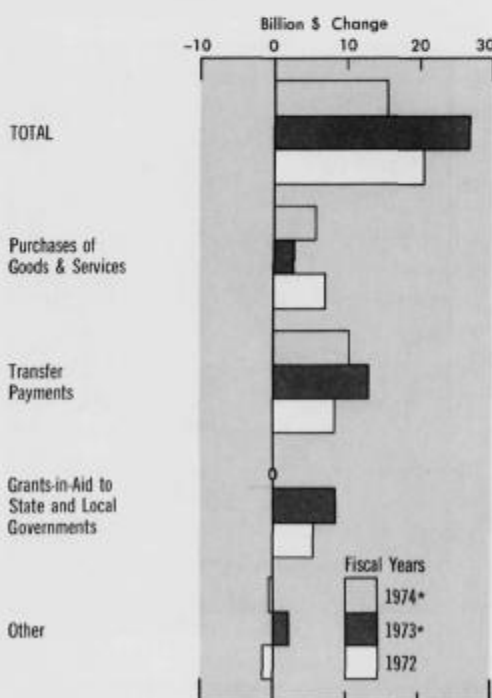
	1972 actual	1973	1974
		Estimates	
Department of Defense, military	75.2	74.2	78.2
Military personnel.....	23.0	23.1	22.5
Retired military personnel.....	3.9	4.4	4.7
Operation and maintenance.....	21.7	21.5	21.7
Procurement.....	17.1	15.6	16.5
Aircraft.....	5.9	n.a.	n.a.
Missiles.....	3.0	n.a.	n.a.
Ships.....	2.0	n.a.	n.a.
Vehicles and ordnance.....	3.5	n.a.	n.a.
Electronics and communications.....	.9	n.a.	n.a.
Other.....	1.7	n.a.	n.a.
Research, development, test, and evaluation.....	7.9	7.6	8.1
Other.....	1.5	1.2	1.6
Civilian and military pay increases ¹.....	.....	.7	2.7
All-volunteer force.....	.....	.....	.1
Military retirement system reform.....	.....	.....	.4
Military assistance.....	.8	.6	.8
Atomic energy and other defense-related activities	2.4	1.6	2.1
Total unified budget outlays for national defense	78.3	76.4	81.1
Less: Transfers, grants, interest.....	4.2	4.7	5.5
Timing differences and other adjustments.....	-.2	-2.9	-.3
Equals: National defense purchases, NIA	74.3	74.6	75.9

1. Includes only pay raises effective January 1, 1973 and 1974.

Sources: "The Budget of the United States Government, 1974," Department of Defense, and BEA.

Changes in Federal Government Expenditures (NIA Basis)

CHART 11



*Estimate by BEA.

U.S. Department of Commerce, Bureau of Economic Analysis

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amounts, defense purchases are projected to decline \$2.2 billion in 1973 and \$0.4 billion in 1974. Excluding the pay raises shown in table 9, military personnel costs decline \$0.6 billion in 1974. Military personnel at June 30, 1974, is estimated at 2.2 million, the lowest level since before the Korean War and more than 1.3 million below the Vietnam War peak reached in mid-1968.

Operation and maintenance outlays increase slightly to \$21.7 billion in 1974, reflecting increased civilian pay (despite a drop of 24,000 in civilian employment) and ship alterations and weapons modification. Procurement of military hard goods as recorded on a delivery basis in NIA declines more than \$1.5 billion in 1974 after advancing \$1 billion in the current fiscal year. (This is in contrast to cash payments for procurement, shown in table 9, which increase \$1.5 billion in 1973 and decline \$0.9 billion in 1974.) Other increases in defense spending occur in research and development (\$0.5 billion), new construction and other DOD activities (\$0.4 billion), and atomic energy and

other defense related activities (\$0.5 billion).

Budget estimates of Department of Defense (DOD) outlays (which were prepared prior to the cease fire agreement) include \$5.9 billion for expenditures in Southeast Asia in the current fiscal year and \$4.1 billion in 1974. It is estimated that the bulk of the \$5.9 billion has already been spent. It is uncertain how much of the remaining funds will be needed for other purposes in Southeast Asia, such as clearing harbors of mines. Excluding these outlays, DOD expenditures in the unified budget would show an increase of \$5.8 billion in fiscal 1974.

Large gain in nondefense purchases

Nondefense purchases advance \$4.5 billion in 1974, compared with \$2.3 billion in the current fiscal year. The purchase of agricultural products by the Commodity Credit Corporation (CCC) accounts for \$1½ billion of the advance, pay raises for about \$¾ billion, capital outlays of the Postal Service for \$½ billion, administrative costs associated

with the Federal takeover of certain State welfare programs for \$½ billion, with the remaining increases—about \$1¼ billion—distributed over a wide range of other programs.

The advance in CCC purchases reflects a modest increase in activity in 1974 following a large decline in 1973 resulting from higher market prices and expanded exports. Increases occur in other nondefense purchases for such programs as veterans' medical care and hospital services, law enforcement and justice, and civil rights enforcement. Space outlays, which have continuously declined since 1966—from about \$6 billion to \$3 billion in 1973—show a modest gain.

Transfer payments continue to advance

Expenditures other than for purchases of goods and services increase about \$10 billion in 1974, following a rise of more than \$24 billion in fiscal 1973. The 1974 advance is entirely in personal transfer payments; other expenditures combined—grants to State and local governments, net interest paid, subsidies (less the current surplus of government enterprises), and foreign transfers—are unchanged.

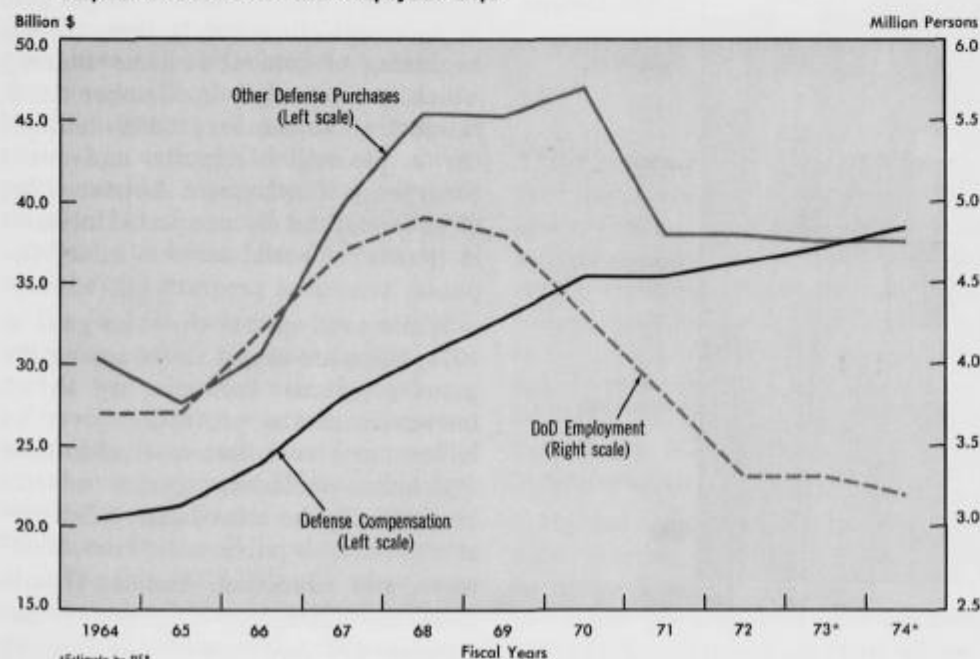
Personal transfer payments rise \$10.2 billion, following an increase of \$13.1 billion. The increase will raise transfers to over \$99 billion—3½ times the level of a decade ago and more than \$23 billion larger than 1974 defense purchases. This growth of transfers has resulted from increases in average benefits and in the number of beneficiaries as well as from the introduction of new programs, such as medicare, food stamps, and special benefits for disabled coal miners.

Social security benefits (excluding medicare) account for more than \$5½ billion of the 1974 advance in personal transfers, with over \$2 billion resulting from the 20 percent benefit increase effective in October 1972. About \$1½ billion results from various social security amendments enacted in late 1972 (effective January 1973) which: (1) increased widows' benefits up to the amount their deceased

CHART 12

National Defense Purchases and Defense Department Employment

Compensation continues to rise as employment drops



*Estimate by BIA

U.S. Department of Commerce, Bureau of Economic Analysis

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husbands would have received; (2) allowed beneficiaries to earn more without a reduction in benefits; and (3) included other changes, such as a new minimum benefits calculation. Hospital and medical payments under the medicare program are expected to advance \$2¼ billion in 1974. Included in this increase is over \$1¼ billion for extension of benefits (effective July 1973) to disabled persons under 65 years of age.

In 1974, the Federal takeover of certain State administered programs providing welfare payments to the aged, blind, and disabled add \$1¼ billion to transfers. On January 1, 1974, the Federal Government will take over these programs, but States will continue to administer the large program of aid to families with dependent children (AFDC). Under the existing adult welfare program, Federal

grants to States finance part of the State transfer payment to individuals. The new program will provide for a minimum Federal payment of \$130 a month to a single person without other income and \$195 to a couple. Matching grants for the current program will be discontinued.

Unemployment benefits decline \$¼ billion in both 1973 and 1974, from a level of \$6 billion in 1972 to slightly over \$4½ billion in 1974. These estimates are consistent with the expectation, stated in the *Annual Report of the Council of Economic Advisers*, that the unemployment rate will decline to about 4.5 percent by the end of calendar 1973, as compared with 5.1 percent in December 1972.

Other transfer payments advance \$1¼ billion in 1974 as compared with about \$4¼ billion in the current fiscal year. The 1974 gain is the net result of growth

Table 10.—Estimated General Revenue Sharing Outlays, Fiscal Years 1973-77

[Billions of dollars]	
1973.....	6.8
1974.....	6.0
1975.....	6.2
1976.....	6.3
1977.....	4.9
Total.....	30.2

Source: "The Budget of the United States Government, 1974".

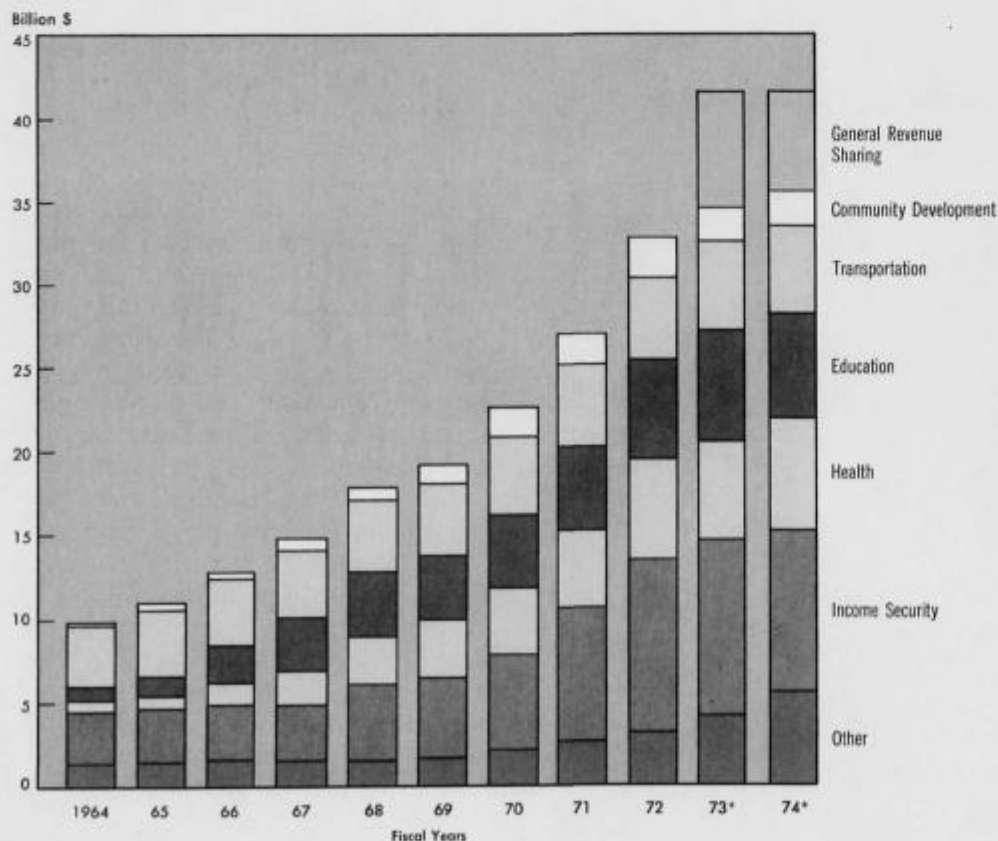
in student assistance and civilian and military retirement benefits, and declines in special benefits for coal miners (\$½ billion) which were boosted by retroactive payments in 1973, and in veterans' benefits (\$½ billion). The food stamp program—which increased nearly \$2 billion in the 1969-73 period—is unchanged in 1974.

Foreign transfer payments, mainly economic assistance to foreign governments and retirement payments to individuals living abroad, are also unchanged. The budget estimates do not include post-war economic assistance to Southeast Asia.

CHART 13

Federal Grants-in-Aid

Revenue sharing boosts grants in 1973 and 1974



*Estimate

Grants are stable

The new budget projects grants of \$41.6 billion in 1974, the same as in 1973, when grants increased \$9 billion (chart 13). This unusually large gain is the result of several factors: (1) the beginning of general revenue sharing, which was enacted in October 1972, retroactive to January (\$6¼ billion); (2) a peaking of grants under the Emergency Employment Assistance Act (\$½ billion); and (3) unexpected increases in grants for social services under the public assistance program (\$½ billion).

While total grants show no gain in 1974, there are major shifts among the grant programs. Increases are shown for environmental protection (over \$¼ billion), and law enforcement assistance (\$¼ billion including special revenue sharing). On the other hand, older programs, such as public assistance, highways, and education, decline. Grants under the Emergency Employment Assistance Act also decline from over \$1 billion in 1973 to \$½ billion in 1974.

Expenditures for general revenue sharing amount to \$6.8 billion in 1973 and decline to \$6 billion in 1974. The decline results from the fact that 1973 includes the equivalent of five quarterly payments (representing the entire calendar 1972 entitlement plus the first quarter entitlement for calendar 1973) while 1974 includes only four quarterly payments (representing the remaining three quarters of calendar 1973 and the first quarter of calendar 1974).

General revenue sharing authorizes quarterly payments totaling \$30.2 billion over the period calendar 1972 to 1977 (table 10). These funds are distributed among the States on the basis of formula, with one-third of the funds going to State governments and two-thirds going direct to local governments.

Expenditures for the largest grant program, public assistance, decline about $\frac{1}{2}$ billion to \$12½ billion in fiscal 1974. This decline is the result of: (1) program savings (effective January 1, 1973) under enacted legislation which allows States to curtail certain medicaid services and begin to charge a fee to medicaid beneficiaries; (2) the elimination on January 1, 1974, of grants for welfare assistance to the aged, blind, and disabled; as already noted, these grants are replaced by direct transfer payments; and (3) a leveling off of outlays for the AFDC program.

Education grants are down slightly and there are also significant shifts in the composition of the programs: (1) the replacement of grants to universities by over $\frac{1}{2}$ billion of direct payments to students; and (2) the substitution of special revenue sharing of about \$1½ billion for 30 categorical grant programs.

The budget includes a renewed proposal for special revenue sharing. The new proposal combines the existing funds from many current categorical grant programs into four programs of broad-purpose grants. When fully effective, it would provide more than \$7 billion to State and local governments for education (\$2.8 billion), urban community development (\$2.3 billion), manpower training (\$1.3 billion), and law enforcement (\$0.8 billion).

Continuing deficits increase interest payments

Net interest paid increases \$1.2 billion to \$15.8 billion in 1974. This large increase, and the \$1.1 billion increase in the current year, are primarily the result of budget deficits, and secondarily of higher interest rates. Debt held by the public (including the Federal Reserve System) increases \$25 billion in the current fiscal year and \$16½ billion in 1974. Government interest payments to foreigners, which have risen rapidly in recent years, are excluded from this NIA category. They are treated as a government purchase and also as an import, and thus do not affect total GNP.

Subsidies (less the current surplus of government enterprises) decline \$1.5 billion in 1974 after advancing \$1.1 billion in the current fiscal year. Major declines are in payments to farmers (\$1 billion), the operating deficit of the CCC (\$½ billion), and in the temporary disaster relief program (\$½ billion). Increases occur in the postal deficit and in housing subsidies.

New financing agencies

The budget introduces three new institutions intended to improve the financing of Federal programs. These are the Federal Financing Bank (FFB), the

Environmental Financing Authority (EFA), and the Student Loan Marketing Association (SLMA). Under proposed legislation, the FFB, a Government-owned agency, would consolidate and improve the efficiency of financing Federal agency obligations and federally guaranteed private loans. It would purchase many of these obligations, financing the acquisitions with sale of its own debt issues to the public. Federally sponsored, but privately owned agencies such as FNMA, would be excluded from use of the FFB, but their borrowings would continue to be coordinated with Treasury under existing arrangements. The EFA, also a Government-owned enterprise, will begin operating in fiscal 1974. State or local public bodies, eligible for a grant from the Environmental Protection Agency for 75 percent of the cost of constructing waste treatment facilities under the Federal Water Pollution Control Act, and unable to borrow at reasonable terms in the private market, would apply to EFA for loans to meet their 25 percent share under that act. EFA would issue its own taxable securities to finance these loans. SLMA, a Government-sponsored, privately owned agency, will begin in 1973 to purchase student loans from private lenders, financing its purchases by borrowing from the public.

Fiscal 1975 Expenditures

THIS year's budget presents for the first time a detailed preview of outlays and receipts on a full employment basis beyond the budget year. It projects full employment outlays of \$288 billion and full employment receipts of \$290 billion in fiscal 1975. Outlays are presented in agency and functional detail; no detail is shown for receipts. Fiscal 1975 outlays on the NIA basis shown in table 11 are estimates of BEA.

Federal expenditures on the NIA basis increase \$18½ billion from 1974 to 1975. Transfer payments account for about \$9 billion of this advance, followed by grants-in-aid (\$3½ billion), defense purchases (\$3 billion), non-

Table 11.—Unified Budget Outlays and Federal Expenditures on the NIA Basis, Fiscal Years 1974 and 1975

(Billions of dollars)		
	1974	1975
Unified budget outlays.....	289	288
Reconciliation items.....	7	8
Federal expenditures, NIA basis.....	276	284
Purchases of goods and services.....	112	117
Defense.....	78	79
Other.....	30	38
Transfer payments.....	102	111
Personal.....	10	108
Foreign.....	3	3
Grants-in-aid.....	42	45
Net interest paid.....	16	18
Subsidies less current surplus.....	6	6

Sources: "The Budget of the United States Government, 1974," and 1975 estimates by BEA.

defense purchases (\$2½ billion), and subsidies (less the current surplus of government enterprises) and net interest (about \$¼ billion each).

Automatic increases in social security benefits (under legislation enacted in 1972) are a factor in the advance of transfer payments as is the full year

impact of the previously discussed Federal takeover of selected State welfare programs. Grants are boosted by additional funds for waste treatment and for special revenue sharing. Pay increases account for a significant part of the advance in defense and other purchases.

Unified Budget-NIA Reconciliation

THE differences between the unified budget and the NIA Federal sector can be summarized under the following major categories: (1) coverage; (2) financial transactions; (3) netting and grossing; (4) timing; (5) land transactions; and (6) miscellaneous. Table 12 shows a summary reconciliation of Federal receipts and outlays as recorded in the unified budget and in the NIA.

Coverage

The unified budget includes receipts and expenditures associated with territories and possessions—such as the Virgin Islands, Puerto Rico, and Guam—that are excluded from the NIA. An adjustment is made to both receipts and expenditures for these transactions. Adjustment is also made for various deposit fund transactions which are excluded from the budget but included in the NIA. In recent years, the major deposit fund adjustment has involved royalties received from Louisiana off-shore oil leases. Because of a dispute over the ownership of these royalties, the Federal Government put the annual payments into an escrow account. A Supreme Court order awarded over \$1 billion of these funds to the Federal Government, and the unified budget records the transfer as an offset to 1973 expenditures. The NIA has recorded the annual royalty payments as business nontax receipts, necessitating an adjustment from the budget basis to the NIA basis. In 1973, an adjustment is necessary in order to offset the

negative impact of these receipts on budget expenditures.

Beginning with fiscal 1974, the unified budget totals include only the Federal payments to the Postal Service; in contrast, the NIA continues to record capital spending by the Postal Service as part of nondefense purchases, and the postal operating deficit as part of subsidies net of the current surplus of government enterprises. In 1974, the excess of NIA Postal Service expenditures over the Federal payment included in the unified budget is \$1.2 billion.

Financial transactions

Unified budget outlays include net lending, while the NIA excludes all loans except most CCC price-support loans, which are recorded as Federal purchases and as a part of farm income. Loan transactions excluded from the NIA but included in the unified budget are \$1.5 billion in fiscal 1974. Also in the category of financial transactions is an adjustment for purchases of foreign currency. The unified budget includes them while the NIA excludes them as an exchange of assets.

Netting and grossing

This adjustment affects only the levels of receipts and expenditures and not the difference between the NIA deficit and the unified budget deficit. The largest item in this category is the Federal Government's contribution to employee retirement funds. These con-

Table 12.—Relationship of Federal Government Receipts and Expenditures in the National Income Accounts to the Unified Budget, Fiscal Years 1972-74

(Billions of dollars)			
	1972	1973	1974
Receipts			
Unified budget receipts.....	268.6	225.0	256.8
Coverage differences.....	—1.1	—1.2	—1.3
Netting and grossing.....	4.6	5.8	5.7
Timing differences.....	—1.2	3.6	1.7
Miscellaneous.....	—	—	—1.1
Federal receipts, NIA basis.....	261.9	235.3	261.8
Expenditures			
Unified budget outlays.....	231.9	249.3	256.7
Coverage differences.....	—1.4	.6	.6
Outer continental shelf deposit funds.....	—	1.1	—
Postal Service.....	—	—	1.2
Other.....	—1.3	—1.5	—1.6
Financial transactions.....	—2.4	—1.0	—1.5
Net purchases of land.....	.3	2.0	1.0
Netting and grossing.....	4.6	5.8	5.7
Timing differences.....	—1.3	2.5	.3
Miscellaneous.....	—	—	—1.3
Federal expenditures, NIA basis.....	230.1	259.9	275.5

Sources: Estimates by the Office of Management and Budget and BEA.

tributions are excluded from total budget expenditures as intragovernmental transactions. The NIA considers these contributions to be part of employee compensation and includes them as purchases of goods and services and as contributions for social insurance. In fiscal 1974, this adjustment amounts to \$4 billion.

Other netting and grossing consists primarily of money received from the public recorded as offsets to expenditures in the unified budget. For instance, receipts from two major veterans' insurance programs—National Service Life Insurance and U.S. Government Life Insurance—are netted against expenditures of these programs. In the NIA, this income is treated as receipts in the form of social insurance contributions. These and similar netting and grossing adjustments add about \$1.7 billion to the level of NIA receipts and expenditures in 1974.

Timing

The unified budget records receipts at the time cash is collected regardless of when the income is earned; expenditures—except interest, which is recorded

(Continued on page 40)